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SUBJECT: PAKISTAN EXPECTS TO MEET AMBITIOUS TAX COLLECTION TARGET

Summary

¶1. (SBU) The Federal Board of Revenue expects to meet its annual tax collection target of Rs.1.025 trillion (\$16.8 billion). The first quarter tax (July - September 2007) collection is up by 21.1 percent, compared to the same period of last year, but falls short of the FBR's self-imposed target of Rs.218 billion (\$3.57 billion). The FBR attributes this shortfall to transition to new electronic tax filing system, and hopes to recoup the lost revenue in the coming months. FBR maintains that there has been no increase in tax avoidance and non-compliance, but admitted it is facing resistance from the services sector to any increased taxes. The FBR has contacted with Georgia University to research methods to tax under-taxed sectors, in particular the services sector. End summary.

FBR Confident It Will Meet Its Annual Tax Target

¶2. (SBU) Econ Officers met Dr. Ather Maqsood, Chief of Research Service of the Federal Board of Revenue (FBR), October 30 to discuss reports that the FBR will not be able to meet its annual tax target of Rs.1.025 trillion (\$16.8 billion), due to an increase in non-compliance and a drop in the number of tax filers. Maqsood refuted these reports, asserting that the FBR will be able to meet its annual tax collection target, provided the economy continues to grow at the same pace and there is political stability. (Note: We met with Maqsood three days before the imposition of the state of emergency. End note.) The government has projected 7 percent GDP growth and a 6.5 percent inflation rate. He explained that, after graduation from the IMF program, Pakistan is no longer held to binding quarterly tax collection targets. The FBR itself sets monthly and quarterly targets, which may be adjusted.

Transition to Modern System Causes Shortfall in the First Quarter Tax Collection

¶4. (SBU) The Federal Board of Revenue is modernizing its collection systems, and moving to an electronic filing and collection system. Maqsood attributed the shortfall in first quarter tax collections to the transition and initial operational problems with the new computerized system. He was confident that this loss will be recovered in the coming quarters. The FBR collected Rs. 257.85 billion (\$4.23 billion) in taxes from July-October 27, compared to Rs.212.92 billion (\$3.49 billion) in the same period last year, an increase of 21.1 percent.

Tax evasion did not increase, but low GDP-tax ratio persists

¶5. (SBU) Contrary to press reports, there was no increase in tax evasion, and Maqsood emphasized that the number of individuals

filling income tax actually increased by 11.1 percent, from 1.8 million to 2.0 million in the last year. He said the low number of individuals filing income tax is also due to the fact that some income tax payers are not required to file returns, and are not counted in the statistics for individuals filing income tax.

¶6. (SBU) Maqsood, however, acknowledged that the tax to GDP ratio is very low and some sectors are under-taxed. He cited the example of the services sector which comprises 50 percent of GDP, but its tax contribution is only 30 percent of GDP. The financial sector only began paying federal excise tax on cash withdrawals and letter of credit transactions from last year. Maqsood said that the FBR is facing opposition from the services sector on imposition of new taxes. Lawyers and doctors do not pay taxes on services rendered. Whenever the government tried to levy taxes on their services, they have resisted it. Only the telecoms and the banking sectors are adequately taxed. There is a 15 percent sales tax on cell phone bills, which Maqsood described as a good revenue generator for government, given the tremendous increase in the use of cell phones.

Studies Underway to Broaden Base and Increase Tax Collection

¶7. (U) The Federal Board of Revenue has contracted with Georgia State University for a project on tax policy reforms. The project will examine the gap between each sector's tax contribution and what should it pay. The project is likely to benefit Pakistan in improving tax compliance and in generating revenue from the under-taxed sectors, particularly the service sector.

Comment

¶8. (SBU) Comment: While the Federal Bureau of Revenue has made

ISLAMABAD 00004831 002 OF 002

significant progress over the past few years in generating additional tax revenue because of tax policy and administrative reforms, it must now focus seriously on broadening the tax base. Pakistan is now a services-based economy, so taxation of this growing sector is essential to close the government's fiscal deficit. We will be tracking the FBR's revenue collection in the coming months to see how the state of emergency and political uncertainty affects Pakistan's economy. End comment.